BEFORE THE

PUBLIC SERVICE COMMISSION

OF SOUTH CAROLINA

DOCKET NO. 2017-381-A

In Re:

Office of Regulatory Staff's Petition for an)
Order Requiring Utilities to Report the Impact)
Of the Tax Cuts and Jobs Act)
)

RESPONSE TO ORS MOTION

Palmetto Wastewater Reclamation LLC ("PWR"), pursuant to 10 S.C. Code Ann. R.103-829.A (2012), submits the within response in opposition to the Office of Regulatory Staff ("ORS") "Motion to Preserve Tax Benefits for Ratepayers" served on PWR by United States Mail on April 6, 2018 ("Motion"). Based on a number of incorrect assumptions, the Motion seeks to have the Commission impermissibly set rates based on a change in a single expense, engage in improper retroactive ratemaking, ignore statutory procedures governing the Commission's ability to reduce public utility rates, deny utilities both procedural and substantive due process, and effect an impermissible taking of private property for private use. For these reasons, as further discussed below, the Motion should be denied.

INCORRECT ASSUMPTIONS UNDERLYING THE MOTION

1. The federal Tax Cuts and Jobs Act, Public Law 115-97 (the "Act") was signed into law on December 22, 2017, governs Federal income tax liability for tax year 2018, and, among other things, reduces the corporate income tax rate from a maximum of 35% to 21%.

While ORS is correct in asserting that "[m]any [u]tilities recover federal income tax expenses at the corporate rate of 35% through tariff rates charged to utility customers,"[1] this does not mean – contrary to the implied assumption of the Motion – that such utilities are necessarily earning in excess of their authorized returns as a result. To the contrary, PWR asserts that it is likely that many utilities – even with a decrease in federal corporate income tax liability – may be earning less than their returns authorized by the Commission.

2. Similarly, the fact that the federal corporate income tax rate has been reduced does not in and of itself mean that the income tax expense component of authorized rates is now exceeded by the dollar differential between income taxes under the prior and current federal rates; this is so because the Act contains other provisions which may increase the federal income tax liability of some utilities. As the Commission observed in its recent order issued in the Palmetto Utilities, Inc. rate case, "ORS proposes to implement provisions of the Act that reduce taxes, but ignore the Act's provisions that (by its own admission) increase taxes."[2] The Motion appears to assume that "the full benefits of the Act" consist of this dollar differential and not the difference between actual taxes paid and to be paid by utilities.

3. Moreover, the Motion assumes that the PWR comments on the initial ORS petition in this docket reflected that PWR did not "contest[ ] that benefits accrued to ratepayers with the

[1] *See* Motion para. 2. It should be noted that for some corporate taxpayers, including Palmetto Utilities, Inc., the prior rate was 34% and not 35%. *See* Order No. 2018-155, issued March 7, 2018, in Docket No. 2017-228-S at p.20. PWR was also previously taxed at the 34% rate because its annual revenues are less than $10 Million. *See* 26 U.S.C.A. §11(b)(1)(C) (2017)

[2] *See* Order No. 2018-155 at p.21. Since the issuance of this order, the Commission has authorized PWR (and PUI) to impose a tax multiplier on contributions or advances in aid of construction for the express purpose of reducing the amount of federal income tax liability which would be incurred as a result of §13312(B) of the Act. *See* Order No. 2018-252 in the instant docket.

effective date of January 1, 2018" as a result of the Act. For two reasons, this is also an incorrect assumption by ORS. First, the PWR Comments filed January 24, 2018, clearly state that the Commission should require a report which consists of "a financial statement which reflects (1) 2017 revenues and **expenses (including income taxes)**, (2) **adjusted** 2017 **revenues and expenses taking into account the impact of the Act**, and (3) any additional information which will inform the Commission regarding the overall impact of the Act on PWR's financial status."[3] Thus, rather than focus on the effect of the Act alone, PWR made it clear that the Commission should consider the overall financial condition of a utility when considering the effect of the Act in response to the ORS petition in this docket – not simply the effect of the tax rate differential as ORS's assumption suggests. Second, the Motion assumes that the Act creates "benefits to the ratepayer" and that utilities bear some obligation to "return … the full benefits of the Act to their customers." The Act does not – as it cannot consonant with the United States Constitution – entitle utility customers to a refund of lawful rates which have been charged by utilities. *See* U.S. Const. Amend. V. Furthermore, the Motion's assignation to the Commission of a recognition that Act creates "benefits" for ratepayers is unsupported by any order of the Commission in this or any other docket.[4]

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[3] *See* PWR Comments, January 24, 2018 (emphasis supplied).

[4] Contrary to the Motion, in Order No. 2018-155 the Commission did not "state[ ] that the benefits of the Act should be determined in this docket." See Motion at 2. This order makes no determination that the Act creates benefits for ratepayers; quite the opposite, the Commission ruled in Order No. 2018-155 that it could not adopt ORS's recommendation that PUI's income tax expense be adjusted downward only to reflect the reduction in the tax rate from 34% to 21% "because the effect of the Act is not a known and measurable change." *Id.* at 21. In so ruling, the Commission concluded that ORS sought to have PUI's allowable tax expense reduced based "upon speculation as to what Palmetto's taxes will be in 2018." *Id*. at 21-22. The effect of the Motion, if granted, would be the same as ORS now seeks -- a determination that utility tax expenses have been reduced without any examination by the Commission as to the actual impact of the Act on such expenses and other allowable expenses which are included in current utility rates.

4. The Motion assumes that utilities which have not responded to ORS's March 30, 2018, letter in this docket did not "contest that benefits accrued to ratepayers … effective … January 1, 2018."[5] However, by letter dated April 11, 2018, PWR has timely[6] stated its disagreement with the assertions made by ORS in its March 30, 2018 letter, and this assumption is therefore also incorrect.[7]

SINGLE EXPENSE RATEMAKING

5. The Motion implies that a just and reasonable utility rate may be determined with reference to a single expense which forms a component of the utility rate, without consideration of the other expense components and authorized revenues which are approved by the Commission. This is incorrect as the Commission is required to set rates

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[5] *See* Motion at 3, para. 9.

[6] *Cf.* 10 S.C. Code Regs. RR. 103-829 and 103-831 (2012) and Rule 6, SCRCP.

[7] The Motion also includes other unsupported or incorrect statements which do not warrant a grant of the relief requested and which the Commission should disregard.

For example, the Motion states that "[i]ncome tax expense is an expense on which utilities should have no earnings benefit." Although it is unclear exactly what this statement means, to the extent it is intended to suggest that an income tax expense is not recoverable in rates, it is without merit. *See Hamm v. Public Service Com'n, supra*. There is no disputing that income taxes are an expense of operating a utility. Alternatively, to the extent this statement is intended to suggest that because a utility's rate base may be reduced to account for the effect of accumulated deferred income tax ("ADIT") liability, the verity of such a suggestion does not prevent a utility from including income taxes in allowable expenses. In fact, such a suggestion only supports PWR's contention that the effect of the Act must be considered in view of all of a utility's allowable expenses and revenues and not in the context of the abbreviated and incomplete analytical structure suggested by the Motion. *See* discussion at para. 1, *supra*, and para. 7, *infra*. And, to the extent this statement is intended to suggest that income tax expenses should be a direct pass-through to customers, as opposed to being one component of a utility's overall rates, it is also without merit as there is no provision of law or Commission order providing for a pass-through of income taxes. *Cf. City of Spartanburg v. Public Service Com'n*, 281 S.C 223, 314 S.E.2d 599 (1984) (affirming Commission approval of a telephone tariff provision passing through to utility customers within a municipality a portion of that municipality's business license tax and recognizing that taxes applicable statewide are not appropriately passed through).

Another example is the statement in the Motion that "lowering revenues" will prevent "Utilities [from] retain[ing] ratepayer funds that properly belong with the ratepayers." *See* Motion at 4, para. 10. This statement is based on the assertion that "ratepayers should receive any benefits associated with the Act." *Id.* at 3. In addition to assigning a meaning to the Act that is unsupported by any of its provisions, this statement ignores basic South Carolina jurisprudence which forbids the Commission from retroactively changing a lawful rate. *See* discussion at para. 5, *infra*.

which allow a utility to recover all of its expenses of operation and earn an allowable return. In setting just and reasonable rates, the Commission is required to approve revenues and an operating margin within a reasonable range. *See Seabrook Island Property Owners Ass'n v. S.C. Public Service Com'n*, 303 S.C. 493, 401 S.E.2d 672 (1991). When approving allowable revenues, the Commission "must authorize sufficient revenue to afford utilities the opportunity to recover expenses." *See Hamm v. Public Service Com'n*, 310 S.C. 13, 16, 425 S.E.2d 28, 30-31 (1993). The Commission may not, as the Motion assumes it may do, determine the reasonableness of rates by reference to a single expense (here, corporate income taxes). All expenses and the revenues necessary to meet the approved return must be considered together.

THE MOTION PROPOSES IMPROPER RETROACTIVE RATEMAKING

6. Notwithstanding its assertion that the Motion does not implicate retroactive ratemaking because it seeks a "prospective return of the benefits of the Act" in order to prevent "a windfall for the Utilit[ies],"[8] the Motion quite clearly proposes that the Commission engage in retroactive ratemaking as it proposes a "true-up" that would require utilities at some point to refund a portion of revenues now being lawfully collected under approved rates. This is prohibited by South Carolina law. *See S. C. Electric & Gas Co. v. Public Service Commission*, 275 S.C. 487, 491, 272 S.E.2d 793, 795 (1980) (holding that "[t]he Commission has no more authority to require a refund of monies collected under a lawful rate than it would have to determine that the rate previously fixed and approved was unreasonably low, and that the customers would thus pay the difference to the

[8] *See* Motion at 4, n.15.

utility"). *See also Porter v. South Carolina Public Service Com'n*, 328 S.C. 222, 234, 493 S.E.2d 92, 99 (1997) (observing that "[i]n *S.C. Electric & Gas Co. supra*, we held the Commission could not order a refund for excess revenue collected under a past-approved rate because this would violate the rule against retroactive rate-making" and that "there is no violation of the rule against retroactive rate-making where the reduction sought is *prospective only*"). Further, whether any "windfall" results from the reduction in the Federal corporate income tax rate as the Motion asserts[9] would be a question of fact peculiar to each and every utility, taking into account whether the reduction results in earnings exceeding a utility's authorized return. Notwithstanding, even if a windfall does result, it cannot lawfully be addressed in the manner proposed by the Motion. *See Moody v. City of Orangeburg*, 319 S.C. 184, 187, 460 S.E.2d 374, 375 (1995), citing *South Carolina Electric & Gas Co., supra* for the proposition that the Court there "also concluded that when a windfall results from a *lawfully* established rate, the proper remedy is prospective rather than retroactive".

THE MOTION IGNORES THE PERTINENT STATUTORY PROCEDURE

7. The Commission's authority to prospectively reduce a lawful rate is found in S.C. Code Ann. § 58-5-290 (2015). *See Porter, supra* , 328 S.C. at 235, 493 S.E.2d at 99 ("[c]learly, under this statute, the Commission has the continuing power to **prospectively** correct or reduce a previously approved charge"). (Emphasis supplied.) Despite professing that the relief sought has prospective impact only,[10] the Motion fails to mention this statutory

[9] *See* Motion at 4, n.15.

[10] *See* Motion at 4, n. 15.

source of the Commission's authority to prospectively reduce a previously approved rate. This oversight is attributable not only to the unfavorable case law authority interpreting the statute as having prospective application only, but also to the fact that the statute sets out mandatory and permissive procedures which the Motion does not contemplate. For example, § 58-5-290 requires that the Commission hold a hearing before it can determine whether a previously approved rate is unjust or unreasonable and that it fix a new rate by way of an order. The Motion does not propose any hearing, but instead requires that utilities (which do not agree that an obligation exists for a "return [of] the benefits" under the Act) to revise their tariffs and reduce rates now by "the amount of estimated tax savings", communicate that fact to customers, and have the effect of that rate reduction "true[d] up at a date to be determined by the Commission in a subsequent order." In essence, the Motion proposes that the Commission assume now that a rate is improper, require a revised tariff be adopted, and then determine later what "tax savings" occurred beginning January 1, 2018, that utilities must refund to their customers. In addition to being impermissibly retroactive, this puts the cart before the horse procedurally and requires utilities to take action regarding an allegedly improper or incorrect rate without the benefit of a hearing in violation of § 58-5-290. Similarly, the Motion ignores S.C. Code Ann. § 58-5-300, which allows the Commission to consider all facts (even if they are not referenced in the ORS Petition or Motion) which the Commission may judge to have a bearing upon a proper determination of the question presented. *Porter*, *supra.* The procedure proposed in the Motion does not give utilities notice and an opportunity to be heard with respect to whether a rate reduction is appropriate or whether it can be effective on January 1, 2018 – which is required by law. *Id.* Rather, it improperly presumes that both are the case. For this reason, too, the Motion should be denied.

<u>A GRANT OF THE MOTION WOULD DENY UTILITIES DUE PROCESS AND EFFECT AN UNLAWFUL TAKING</u>

8. The Motion requests that certain utilities be required to determine estimated savings resulting from the "federal tax differential" and to file revised tariffs reflecting the effect of these estimated savings so that a "true-up" to be determined by the Commission in a subsequent order can be applied to their authorized revenues. This procedure does not accord such utilities notice and an opportunity to be heard regarding the existence of any such savings, the impact of other changes in utility revenues or expenses on their authorized returns, and the entitlement of customers to refunds, all of which is required by S.C. Const. art. I, §22. To the contrary, this procedure would allow for ratemaking based on the level of a single expense without consideration of all of the elements of a utility rate. *Cf. Hamm v. PSC, supra*. Accordingly, a grant of the Motion would deny utilities procedural due process of law. Further, because of the retroactive nature of the relief requested, a grant of the Motion would deny these utilities substantive due process under U.S. Const. Amend. V and S.C. Const. art. I §3 and sanction a taking of private property for private use in violation of S.C. Const. art §13.

For all of the foregoing reasons, PWR submits that the Motion should be denied.

Respectfully submitted,

s/John M. S. Hoefer________________

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This 16th day of April, 2018
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